

VZCZCXRO2479
RR RUEHCN RUEHGH
DE RUEHBJ #3684/01 1790032
ZNR UUUUU ZZH
R 280032Z JUN 06
FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC 0437
RUCPDOG/USDOC WASHDC
INFO RUEHCN/AMCONSUL CHENGDU 6646
RUEHGX/AMCONSUL GUANGZHOU 0928
RUEHHK/AMCONSUL HONG KONG 7730
RUEHGH/AMCONSUL SHANGHAI 5108
RUEHSH/AMCONSUL SHENYANG 6441
RUEHIN/AIT TAIPEI 5764
RUEATRS/DEPT OF TREASURY WASHDC
RUEHGV/USMISSION GENEVA 1206

UNCLAS SECTION 01 OF 02 BEIJING 013684

SIPDIS

USDOC FOR DAS LEVINE AND 4420/ITA/MAC/CEA/MCQUEEN
STATE PASS USTR
USTR FOR STRATFORD/WINTER/MCCARTIN/GRIER
USTR FOR MCHALE/WINELAND
TREASURY FOR OFFICE OF INTERNATIONAL INVESTMENT
TREASURY FOR OASIA/ISA-DOHNER AND KOEPKE
GENEVA PASS USTR

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [ETRD](#) [EINV](#) [ECPS](#) [PGOV](#) [ASEC](#) [WTRO](#) [CH](#)

SUBJECT: VOIP: A CASE STUDY OF CHINA'S INTERNECINE PROFIT
WARS

REF: STATE 12988

¶1. (SBU) Summary: In an informal interview during the June 14-16 China VoIP Conference & Expo in Beijing with Dr. Kan Kaili, Director of the Policy and Development Institute of Information Industries at Beijing University of Post and Telecommunications, he likened the profit wars between China's major telecom players as an internecine fight guided by the bottom line, profit quotas, and the need to please both Beijing Central Government officials and company headquarters. End Summary.

¶2. (SBU) In a candid analysis of the future of Voice Over Internet Protocol (VoIP) in China, Dr. Kan, a very influential Stanford PhD and former Deputy Director of the Economic and Technological Development Research Center for the now disbanded Ministry of Post and Telecommunications, said that VoIP is alive and well and being exploited by China's major telcos as just another tool to increase profit margins or in some cases to meet monthly profit quotas. In essence, what the consumer wants really has nothing to do with Chinese telcos' business practices.

The Landscape

¶3. (SBU) China Telecom, which has more than 244 thousand employees, is the largest fixed service telecommunications provider in China with USD 21.20 billion in revenue and around 202 million customers in 2005. The company provides services in the west and south of China, including the municipalities of Shanghai and Chongqing, the provinces of Guangdong, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Sichuan, Hubei, Hunan, Hainan, Guizhou, Yunnan, Shaanxi, Gansu and Qinghai and the autonomous regions of Guangxi Zhuang, Ningxia Hui and Xinjiang Uygur. Its main rival, China Netcom, was formed after a 2001 decision to split China Telecom and break its monopolistic hold over China's fixed line phones services. China Netcom provides services in the north of China, including Beijing, Tianjin, Hebei,

Henan, Shandong, Liaoning, as well as in Shanghai and Guangdong. The company, with more than 138 thousand employees, had USD 10.90 billion in revenue in 2005. China Telecom controls 70 percent of the backbone network while Netcom controls 30 percent.

14. (SBU) China Telecom and Netcom are state-owned enterprises (SOE) and parts of their companies are listed on the New York Stock Exchange. Dr. Kan said that the creation of the State-owned Asset Supervision and Administration Commission (SASAC) has made SOEs more powerful and it is understood that these companies can engage in whatever business activities they wish without fear of antagonizing a ministry such as the Ministry of Information Industry (MII). (Note: While the power of these companies is well known, MII still regulates the industry and determines when and who, for example, will receive 3G or VoIP licenses. The great power of SASAC over the SOEs was exemplified when they shuffled the presidents of all the telcos like a deck of cards. End Note.)

VOIP: Just Another Tool to Make Money

15. (SBU) VoIP currently remains unregulated in China and is neither legal nor illegal. Nevertheless, to date, the Chinese Government has exhibited policies and practices that are stifling the growth of any non-domestic VoIP providers. A recent decree that halts the issuance of VoIP licenses until 2008 serves as an example of how much power a company like China Telecom can wield over the legal and regulatory environment. In the meanwhile, China Telecom and Netcom are using VoIP to boost their own revenue

BEIJING 00013684 002 OF 002

streams. Dr Kan explained that both companies are not only encroaching on each other's territory but each provincial branch is also encroaching on its own siblings' territories. For example, when the general manager of a provincial China Telecom branch sees that his branch will not meet that month's profit quota he will have no qualms about going north to try to get more business by undercutting calling rates from a province that Netcom controls. This is done by using VoIP to offer cheaper domestic calling rates and services than Netcom's fixed lines network. Meanwhile, the rivalry does not stop there because that same branch will also try to take business away from another province that China Telecom already controls. Dr. Kan said that the low cost of VoIP technology has given regional companies another tool to increase their revenue streams or meet pre-set quotas. He added that while this may look like chaotic business practices, everybody is making money so the powers that be in Beijing are happy with the status quo.

The Future

16. (SBU) In answering a question about the future of VoIP, Dr Kan said that VoIP is widely available and popular in China and that in the end MII will have no choice but to legalize it. He exemplified this by pointing out that up until 1999 IP telephony was illegal in China but in a manner similar to VoIP was widely available. The government then had no choice but to legalize it and he predicted that VoIP will follow the same path. He concluded by wondering if American companies could really survive in such a business environment in China.

Randt